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# The Municipal Utility and the Liberal Economic Ethic

Charles S. Telly\*

Jack F. Grove\*\*

*The municipally owned and operated utility is something of an anomaly when it is viewed from an economic standpoint. While representing a rather pure form of government ownership of a business enterprise, the municipal utility nonetheless comports with most of the classical tenets of the liberal economic ethic. After briefly tracing the development of that ethic, the authors analyze the municipal utility in light of Home Rule, monopoly regulation, and the ability of such a utility to meet the demands and needs of contemporary society. The authors conclude that the municipal utility, because of its size, local focus, and adherence to the liberal economic ethic, is an idea to be lauded rather than criticized.*

## INTRODUCTION

Since the great period of the eighteenth century, which engendered the basic American economic and political philosophy, government ownership of business has been considered an anathema to a free society. Before the drastic changes in thought of the 1930's, the underlying theme had been that society operated under the belief that people were born with natural, inalienable rights to seek benefits in the marketplace to the enhancement of self-interest. This theme was anchored on the principle that "government [was] created for the purpose of protecting but not depriving [individuals] of their rights, for men will be guided in their transactions by what is good for them, and hence, good for society as a whole."<sup>1</sup>

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1. Telly, *The Classical Economic Model and the Nature of Property in the Eighteenth and Nineteenth Centuries*, 13 TULSA L.J. 406, 407-08 (1978).

The coupling of an individual's inalienable rights with a "protecting" government proved a fertile environment for business enterprise. This system, however, had its faults, and beginning in the 1930's, governmental intervention assumed an increasingly significant role in the play of economic and business matters.

Many industries became subject to the watchful eye of government, and the traditional view of freedom in the market place suffered. Nonetheless, the underlying assumption remaining throughout society was that as little government ownership as possible should be tolerated.

In 1935, the federal government became involved in the regulation of public utilities.<sup>2</sup> Prior to this, only the individual state public utility commissions regulated them, especially in the matters of rates, services, entry, and expansion. Yet, public utilities, though government regulated, are generally (with a few exceptions such as the Tennessee Valley Authority) privately owned.

The municipal utility is an example of an entity which is publicly, not privately owned. This special feature of local public ownership removes its operation from much of the state and federally imposed regulation that prevails over the utility industry at large. The municipal utility is undoubtedly an anomaly in twentieth century business. However, despite much criticism, the municipal utility does not negate the democratic theme, but rather supports it in a unique way, because of the utility's small size, purely local interest, and adherence to one of the central liberal economic principles—profit.

This article will examine the municipal utility, its economic, legal, and political setting, and how it relates to traditional liberal economic principles. However much overlooked, the municipal utility needs to be carefully examined and supported for no greater reason than because it is an idea of merit.

## I. THE LIBERAL ECONOMIC ETHIC

The current antagonism toward the creation or survival of municipally owned utilities stems from the anomalous position that such publicly owned institutions occupy in the American concept of economic freedom. How such a concept developed and how this anomaly was created will be the focus of this section of the article.

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2. Public Utility Holding Company Act of 1935, Pub. L. No. 74-687, 49 Stat. 837 (codified at 15 U.S.C. §§ 79-79z-6 (1970)).

Every society must confront, in one way or another, three fundamental and interdependent problems: (1) what commodities shall be produced and in what quantities; (2) how these goods shall be produced; and (3) for whom shall these goods be produced.<sup>3</sup> In answering these central economic questions, the United States has focused on the changing relationships of freedom and order.<sup>4</sup> In the early stages of this nation's development, individual freedom in economic life was highly emphasized. In a broader sense, the ideal norm of the early American experience was expressed in terms of "Classical Economic Theory"—the generic term for that body of thought which was synthesized and developed in the eighteenth and nineteenth centuries by Adam Smith and his economic disciples.<sup>5</sup>

Underlying this theory are two basic tenets: (1) the "doctrine of the free and responsible individual"<sup>6</sup> and (2) the notion of a natural order in the universe revealed to all men through the power of reason.<sup>7</sup> By following this natural order, man was free to pursue economic self-interest, and thus free enterprise became recognized as a means to individual freedom.

An essential element of individual freedom was the right to own property,<sup>8</sup> the significance of which was the existence of the right to exercise control over the use of things owned. Thus, property rights came to be viewed as the source of economic freedom for the individual. Under the stimulus of the profit motive, individuals were willing to bear risk in a free market economy. Competition forced the market to self-regulate. Therefore, pursuit of self-interest in private property facilitated the natural economic order that worked toward a long-term equilibrium.

One additional principle—laissez-faire—contributed to this free and natural order. This theory calls for minimal governmental interference in economic affairs. It "grew naturally out of the concept that the individual and not the state is the primary object of [economic] concern"<sup>9</sup> and coincided with the view of theorists that concentrated political interference in the economic forum is a

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3. P. SAMUELSON, *ECONOMICS: AN INTRODUCTORY ANALYSIS* 14-15 (9th ed. 1964).

4. T. PETIT, *FREEDOM IN THE AMERICAN ECONOMY* 1 (1964).

5. The principal exponents of this doctrine—aside from Smith—were: Robert Malthus, David Ricardo, James Mill, J.B. Say, N.W. Senior, John Stuart Mill, J.E. Cairnes, and Henry Fawcett. Telly, *supra* note 1, at 406-507.

6. T. PETIT, *supra* note 4, at 119.

7. *Id.* at 95.

8. For an in-depth discussion of this right, see Telly, *supra* note 1, at 406-507.

9. T. PETIT, *supra* note 4, at 119.

threat to individual freedom.<sup>10</sup>

These concepts of individualism, private property, and laissez-faire fostered capitalism and developed into the functional ethic of the American economy under the liberal economic model.<sup>11</sup> They became the basis of an interpretation of freedom which was used to justify the exemption of business enterprise from governmental regulation and interference. The early status of laissez-faire in the minds of the American people, however, was to be greatly eroded by the discontent caused by the Great Depression. Critics of laissez-faire complained that its preoccupation with individualism, fostered in an agrarian society, was not suited to an industrialized society.<sup>12</sup>

The early New Deal administration "stumbled" its way into attempting many things unprecedented in previous administrations.<sup>13</sup> One historian believes that the New Deal had its own "independent, non-theoretical, purely pragmatic origins."<sup>14</sup> But whatever may be said about the New Deal, its policies of governmental action and reaction were initiated to pull the nation out of the Depression.

At this time, John Maynard Keynes effectively "rationalized" or substantiated many of these New Deal actions.<sup>15</sup> Keynesian economic analysis, however, conflicts with the classical theory that economic freedom engenders economic order. Keynes postulated that a capitalist economy is not self-regulating and will function at less than full employment if allowed to operate without external regulation. Thus, Keynes asserted that, contrary to traditional economic theory, what is good for the individual is not necessarily good for society. His solution was not to discard the classical eco-

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10. This viewpoint is shared today by economic conservatives such as Milton Friedman. Friedman cautions against state paternalism by expressing the fear that excessive governmental intervention will inevitably lead to socialism. Freedom and democracy cannot exist in an economic environment which is heavily government-regulated. M. FRIEDMAN, *CAPITALISM AND FREEDOM* 9 (1967).

11. T. PETIT, *supra* note 4, at 118.

12. Hotelling, *The Relation of Prices to Marginal Costs in an Optimum System*, 7 *ECONOMETRICA* 151, 155 (1939). See also HOGSON, *GOVERNMENT OWNERSHIP OF PUBLIC UTILITIES* 71 (1934). Hogson explains that with the increase in businesses taking the corporate form, the owner-entrepreneur has been replaced in management by salaried persons and the shareholder. Individual enterprise has been largely replaced by corporate enterprise. The business form itself has thus grown where it now resembles government.

13. O. TAYLOR, *A HISTORY OF ECONOMIC THOUGHT* 504 (1960).

14. *Id.* at 504 n.7.

15. J. KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* (1936).

conomic model, but rather to modify it, eliminating its flaws by permitting governmental intervention in the model through fiscal policy, monetary policy, and policies affecting consumption and savings.<sup>16</sup>

The New Deal swept aside laissez-faire economics in favor of new policies that rejected the materialistic interpretation of freedom previously discussed.<sup>17</sup> Individualism was sacrificed for collective order under guided capitalism. Governmental controls were acceptable if able to cure certain ills without working undue deprivations on the economic freedom of group interests (such as labor, business, agriculture, and the professions).<sup>18</sup> Freedom and order remained the primary ethical characteristics of the economic system,<sup>19</sup> but the most profound effect of guided capitalism was the displacement of the free market as the ultimate source of economic equilibrium. The functional tools of control, no longer confined to competitive forces, took the form of an interdisciplinary complex.<sup>20</sup>

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16. See P. DEANE, *THE EVOLUTION OF ECONOMIC IDEAS*, 175-80 (1978); R. GILL, *EVOLUTION OF MODERN ECONOMICS*, 85-102 (1967); I. RIMA, *DEVELOPMENT OF ECONOMIC ANALYSIS*, 360-90 (1972).

17. Governmental activity in the name of public interests, while initially confronted with formidable resistance in the courts, was eventually to find a hospitable judicial forum. During the Depression years, the Supreme Court experienced a renaissance-like transformation, especially in interpreting the Constitution. The Justices, spurred to a new level of deference to the Congress and state legislatures by the legal realist movement, exercised judicial restraint in cases where economic controls were at issue. The era of legislative supremacy was thus greeted by the demise of judicially protected laissez-faire, and the pseudo-religious concepts of natural law were subordinated to the democratic values embodied in positive law. Compare *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat) 518 (1819) and *Lochner v. New York*, 198 U.S. 45 (1905) with *Nebbia v. New York*, 291 U.S. 502 (1934) and *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937).

18. See T. PETIT, *supra* note 4, at 240. The author views this approach as a "pluralistic" concept of freedom, whereby policy makers consider the competing goals of interest groups in formulating economic controls. Hence, an institutional reformation occurred when New Deal-influenced political power was substituted for economic power as the means to achieve economic freedom. Government regulation is a functional equivalent to individual rights (of property, for example) insofar as it governs terms of access to power and its use. Competition was replaced, therefore, as the sole institution determining the economic value of legal rights. Professor Samuels explains that the effective rights of economic significance are primarily a function of two forces: the relevant body of law (and its moral counterpart) and market conditions. Under this system, the efficiency of allocation is determined by rights in both respects. Samuels, *Comments on the Social Responsibility of Public Utilities*, in *NEW CHALLENGES TO PUBLIC UTILITY MANAGEMENT* 243, 250 (1974).

19. The operative premise of guided capitalism might read: economic freedom cannot exist without a minimum level of economic order whatever its source. T. PETIT, *supra* note 4, at 196.

20. One author argues that even on a smaller scale, regulation of a public utility should be based upon a blend of analyses, even when the focus of the regulation is pricing.

Placing the task of providing an economic balance in the hands of government—thereby establishing supremacy of political power over economic power—has profoundly influenced this society. It is axiomatic in an industrial society that for political power to be effective, it must become concentrated where economic power is concentrated.<sup>21</sup> Stated simply, the result of this concentration is “big” government possessing a plethora of regulatory arms designed to preserve economic order.

On a value continuum with capitalism and socialism at far poles, this nation’s growth has shifted over time from capitalism to a controlled economy. Such a step to a middle ground is indicative of an attempt to reconcile the individualism and materialism, traditionally associated with economic freedom under the liberal ethic, with the idealistic values of economic order felt in contemporary society. This accommodation by contemporary liberalism illustrates in large part an American dilemma: how to preserve traditional values in such a controlled society.

It is the contention of this article that the liberal economic ethic is still the central theme of modern American society and where possible it should be allowed to remain supreme. Where this is not possible, then as little encroachment on the theme as is necessary should be tolerated. Where considerable governmental intervention seems necessary, then as much of the theme should be preserved as is practical. Throughout, however, there should be an effort to preserve at least a part of the liberal economic ethic as a foundation of traditional values so meaningful to the maintenance of the democratic ideal.

## II. THE PUBLIC UTILITY—THE CASE FOR MONOPOLY REGULATION

In a capitalist economy, monopolies of any kind run contrary to the basic theme of capitalism—freedom. A monopoly by its very nature limits voluntary exchange by reducing the available, alternative sources to which a consumer might turn.<sup>22</sup> It is, in short, a denial of competition caused by the over-development of economic power. This concentration of economic power raises the same fears that exist when political power becomes concen-

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It is more than an exercise in legal procedures; regulation involves broader problems of political economy. Massell, *The Regulatory Process and Public Utility Performance*, in *PERFORMANCE UNDER REGULATION* 113, 113–14 (1968).

21. See T. PETIT, *supra* note 4, at 252.

22. M. FRIEDMAN, *supra* note 10, at 28, 120.

trated.<sup>23</sup> Consequently, the monopoly is an undesirable economic entity that government has actively sought to eliminate.

Within this framework, however, government has given the public utility special consideration and permitted it to operate as a monopoly.<sup>24</sup> Two attributes of public utilities provide the basis for such exceptional status: (1) the essential nature of the services that bear an intimate relationship to the functioning of the community (such as electricity, gas, and water)<sup>25</sup> and (2) the inherent, technical characteristics which cannot be efficiently and economically sustained unless there is a monopoly.<sup>26</sup> If competition is allowed, there will be a duplication of resources (such as tracks, cables, and substations) in a capital intensive industry.

The argument has been made that public utilities operate

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23. C. WALTON, *ETHOS AND THE EXECUTIVE* 234 (1969).

24. One historical reason for this is that public utilities are "affected with a public(k) [sic] interest." In an essay on ports of the sea, Sir Matthew Hale, Lord Chief Justice of the Kings Bench of England, referred to certain wharves in the above fashion. See McAllistor, *Lord Hale and Business Affected with a Public Interest*, 43 Harv. L. Rev. 759 (1929-30); Hamilton, *Affection with Public Interest*, 39 YALE L.J. 1089 (1929-30). Two hundred years later, the Supreme Court of the United States in *Munn v. Illinois*, 94 U.S. 113 (1876), reviewed state legislation regulating grain elevators and, among other things, fixing charges for services rendered by Munn and an associate. The legislation was challenged as a violation of the fourteenth amendment of the Constitution. Chief Justice Waite, in expressing the constitutional issue, declared:

Looking, then, to the common law, from whence came the right which the Constitution protects, we find that when private property is 'affected with a public interest, it ceases to be *juris privati* only.' This was said by Lord Chief Justice Hale more than two hundred years ago, in his treatise *De Potibus Maris*, 1 Harg. Law Tracts, 78, and has been accepted without objection as an essential element in the law of property ever since.

*Id.* at 126. Subsequently, in *Wolff Packing Co. v. Court of Indus. Relations*, 262 U.S. 522 (1923), the idea emerged quite definitely as a "constitutional principle" which was applicable to price regulation. But Chief Justice Taft resolved the group affected with a public interest into classes, which primarily consisted of public utilities on one hand and those in ordinary trade on the other. *Id.* at 535.

In *Nebbia v. New York*, 291 U.S. 502 (1934), the Supreme Court changed its position and eliminated the distinction between public and private business. Thereafter such a distinction became purely one of historical interest. Legislative proposals placing a particular industry under price regulation may now be considered on their merits from the standpoint of economic and social policy, unaffected by possible conflicts with traditional legal doctrines. J. BONBRIGHT, *PRINCIPLES OF PUBLIC UTILITY RATES* 7 (1969). The problem, however, is not yet solved. What was once a distinction between public utilities and trade companies is not followed today, and the waters dividing public utilities (monopolies) and trade companies (non-monopolies) are muddled.

25. J. BONBRIGHT, *PUBLIC UTILITIES AND THE NATIONAL POWER POLICIES* 5-7 (1940). Professor Bonbright belittles this generally accepted aspect of utility status contending that it does not really raise the need for regulation. The service-community relationship does take on central importance, however, with the municipal utility. See also J. BONBRIGHT, *supra* note 24, at 9-13.

26. *Id.*



under conditions of decreasing costs in contrast with competitive enterprises which operate under conditions of constant or increasing costs. Thus, the more output of a public utility plant per day, month, or year, the lower the cost of production and distribution of the kilowatt hour (or gas per thousand cubic feet or miles per passenger). In the final analysis only the company which has a monopoly of supply and service in a particular area can operate economically at a maximum.<sup>27</sup>

Professor Bonbright makes it quite clear that the above position must be carefully "qualified" for it to have significance, because the bald statement also relates to large-scale industrial enterprise economies. The apparent difference is that the monopoly status of a public utility is not just a matter of size, nor is it due to "any indefinite extension of the declining cost portion of a curve relating unit costs of production to scale of output."<sup>28</sup> Rather, it pertains to the extremely localized and thus restricted markets of the utility services. These markets are limited because of the direct connection of the utility plant to the consumers' homes. This competitive hindrance borne by utilities is of no concern to an industrial enterprise whose potential market is not circumscribed by an inherently localized market.<sup>29</sup>

Moreover, Professor Bonbright emphasizes that an industrial concern often realizes decreasing unit costs, but such costs may prove illusory for a utility. Although any specified rate of output can be supplied most economically by a particular single system, the necessary use of an alternative system will reduce the economies of the former.

This concept can best be expressed by example. Assume that three-fourths of a system comes from three extremely economical hydro-electric plants, but no additional water power is available within economical distance. New steam plants, which generate power at a higher cost than hydro-electric plants, must be built. Thus, power is being produced under increasing unit costs. These unit costs may be increased even more if additional steam must be produced to meet the growing requirements of the area. Of

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27. *Id.* See Adams, *Relation of the State to Industrial Action* in TWO ESSAYS BY HENRY CARTER ADAMS 57 (J. Dorfman ed. 1969). Adams states: "The control of the State over industries should be co-extensive with the application of the law of increasing returns." *Id.* at 110.

28. See J. BONBRIGHT, *supra* note 24, at 12.

29. See W. JONES, *REGULATED INDUSTRIES: CASES AND MATERIALS* 12-13 (2d ed. 1976).

course, the increasing cost may be offset by the decline in unit cost of the distribution system, but such a decline is not automatic.<sup>30</sup> (This example applies to many utility companies today and clearly characterizes the famous Tennessee Valley Authority with its increasing dependence upon steam power due to the limits on hydro-electric power.) Then, often because of the capital intensive nature of the public utility and its unique relation to its customers, it is more economical to have a public utility monopoly than two or more companies in direct competition.

Because of their status as authorized monopolies, public utilities are accorded special privileges not otherwise available to private business enterprises.<sup>31</sup> Privileges such as power of eminent domain, permission to use public properties, and relative freedom from competition through government protection against encroachment upon service territory<sup>32</sup> are necessary safeguards of public utility service.

Due to all of these factors, the utility stands as a long-term exception to governmental non-interference with ordinary business enterprise. It is subject to extensive government regulation, which was accepted as the only alternative to outright government ownership and to protect against the abuses of a private monopoly operating without competitive controls. The special duties imposed by the regulatory processes in exchange for private monopoly status are basically the obligations to render adequate service at reasonable rates without unjust discrimination between customers.

### III. MUNICIPAL UTILITY V. PUBLIC UTILITY

What is the case for municipal ownership of a public utility?

It may be argued that even though public utilities are monopolistic enterprises which are heavily regulated, they continue to be "free" enterprises owned by stockholders and managed by independent boards and chief executive officers.<sup>33</sup> On the other hand, the municipal utility is government-owned, and such ownership—critics argue—is another step toward the undesirable

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30. See J. BONBRIGHT, *supra* note 24, at 15.

31. See J. BONBRIGHT, *supra* note 25, at 3.

32. *Id.*

33. This article argues for the municipal utility in the present environment. It is not intended as a critique of the public utility except as it pertains to the municipality. That discussion must remain for another time.

union of political and economic power.<sup>34</sup> Furthermore, the concept of a municipally owned business runs contrary to the warnings of the classical economic theorists against the government interfering with the natural laws of trade and discouraging individual effort.<sup>35</sup>

Professor Bonbright considers the argument that municipal ownership of utilities is a complete combination of political and economic power to be fallacious. The public utility is, in fact, a private business which must make a profit despite being regulated. When a utility is owned and operated by the municipality, there is no reason why it should not make a profit as well.<sup>36</sup>

The significance of this statement becomes clear when one compares services which produce a fair profit to services supplied by the same municipality which are not intended to generate a fair profit. The electricity will generally be sold at rates which yield a revenue equal to cost plus debt-service charges. The costs are carefully designed to have the beneficiary of the service bear the burden, and thus the payment by the beneficiary will be based on the use.

On the other hand, the costs for a city to maintain streets and sidewalks, parks, public schools, health services, and a police system will be met by taxation, with no corresponding effort made to apportion the taxes according to the benefits each individual taxpayer receives. Public schools, tuition-free and subject to compulsory attendance rules, provide an excellent example of this. All taxpayers in the community will pay taxes to support the school system whether they have children or not or whether their children attend private schools. Since the consumer is unable to choose how his income will be disposed of and what benefits he wishes to receive in return for his income, it is easy to note that the manner in which the city operates its schools and most public services is quite dissimilar to that of a regular business. The political and economic powers have been combined and are socialized.

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34. See T. PETIT, *supra* note 4, at 267; see also M. FRIEDMAN, *supra* note 10.

35. See, e.g., R. PORTER, *THE DANGERS OF MUNICIPAL TRADING* 21 (1907). Porter argues that municipal ownership has no proper relationship to the duties which governing bodies were expressly created to perform (*i.e.*, matters of police, health, and education). Industrial and commercial speculation breeds corruption and creates an aristocracy of labor—the "Socialist experience." *Id.* The true duty of local government is to govern and not to trade. *Id.* Municipal leadership should not become involved in the acquisition or management of industries that do not concern the welfare and happiness of all citizens of the community. There should be no exception.

36. J. BONBRIGHT, *supra* note 24, at 22-23.

If the city provided free electric power to the citizens of the community, then, by the same reasoning, the utility system, too, would be socialized. In such case, the public utility would no longer be a business, and it would no longer be a public utility.<sup>37</sup>

Drawing upon the foregoing analysis, Professor Bonbright theorizes that the consumers of public utility services should (1) be allowed to have whatever types and amounts of service they are willing to pay for, but (2) in return they must pay at rates that both reflect the costs of producing those services and produce a reasonable profit.<sup>38</sup> If the municipal utility is left unregulated, it will operate effectively, for the critical factor remains the extent to which the entity is financially self-supporting.<sup>39</sup>

Moreover, Professor Bonbright states that public ownership of a utility is not the potent catalyst of socialism that its critics would make it.<sup>40</sup> If the country's industries are to be "socialized on a wholesale basis, the expropriation of the utility systems will be but a symptom of the movement, not a cause."<sup>41</sup> In addition, the tendency of utilities toward natural monopoly makes the argument for public ownership simply inapposite to the case for a fully socialized industrial economy.

Bonbright also notes that even under private ownership, public utilities are much akin to government agencies.<sup>42</sup> The privately owned utility has legal powers which are usually reserved for government alone,<sup>43</sup> and due to the extensive involvement of state commissions in regulating privately owned utilities, the structure and policies of these utilities frequently reflect the input of the political forum.<sup>44</sup> Factors such as these place even the privately owned utility on the borderline between business and government.<sup>45</sup>

This entanglement is magnified even further in larger consolidated power companies which venture across state lines. These

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37. *Id.* at 23-24.

38. *Id.* at 24.

39. Professor Bonbright believes this point is basic to prevailing theories of pricing for public utility services and to his defense of long-term marginal cost. See J. BONBRIGHT, *supra* note 24, 120, 397-401.

40. J. BONBRIGHT, *supra* note 25, at 58-59.

41. *Id.* at 58.

42. *Id.* at 59.

43. See text accompanying notes 31-32 *supra*.

44. *Id.*

45. *Id.* In his final analysis, Professor Bonbright at least invited experimentation with governmental ownership of utilities. See *id.* at 69.

companies must accede to the regulatory arms of more than one state. Due to its large size, the business assumes a bureaucratic organization similar to that of the agency which regulates it. Consequently, the vestiges of free enterprise and individualism that are retained through private ownership are lost in the functioning of the large regulated utility.<sup>46</sup>

The remarkable aspect of the municipal utility is the manner in which it retains a truly liberal economic character despite the feature of municipal ownership. Home Rule provisions, which place the municipal utilities outside the state regulatory thicket,<sup>47</sup> are largely responsible for this, as they enable the utilities to avoid concentrations of political power operating in the regulatory complex. Whatever political involvement is necessary to operate the utility is exclusively local, thus optimizing the democratic values and freedom which are so closely associated with liberalism.<sup>48</sup> Since distribution of utility services is essentially a local function, regardless of the type of utility service or size of the enterprise, local ownership optimizes the identity of interests among ownership, management, and consumer.<sup>49</sup> While this replaces self-interest and private ownership as the motivating factors for successful operation of the utility, individualism is preserved with the esprit of the community, and sound business practices that meet the consumer's needs are thus incorporated.

#### IV. ENCOURAGEMENT OF THE MUNICIPAL UTILITY THROUGH THE HOME RULE AMENDMENTS IN OHIO

As noted above, municipal utilities avoid many of the difficulties incumbent in state regulation through the power the municipality retains under the Home Rule Amendments of the Ohio Constitution.<sup>50</sup> The general purpose of the Home Rule scheme, of which the utility provisions are a significant part, is to establish the municipal corporation as an autonomous unit within the superstructure of the state and federal system.<sup>51</sup> To accomplish this,

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46. See *id.* at 64.

47. See text accompanying notes 50-64 *infra*.

48. Cf. M. FRIEDMAN, *supra* note 10, at 2-3 (advocating limited scope of government with dispersal of power to local units). Opportunity for individual input is optimally enhanced when local, not state or federal, government is in control of regulation.

49. See E. CLEMENS, *ECONOMICS AND PUBLIC UTILITIES* 559 (1950).

50. OHIO CONST. art. XVII, §§ 4-6. The amendments were added in 1912.

51. G. VAUBEL, *MUNICIPAL HOME RULE IN OHIO* § 2, at 11 (1978). One writer has commented, "The urge for 'home rule' stirs the emotion of municipal officials. They want freedom of action which they believe can come only from the guarantee of home rule to

Home Rule allows for varying forms of municipal organization with full governmental power except where specifically denied or where in conflict with the general laws of the state.<sup>52</sup>

The theoretical basis of constitutional Home Rule lies in a peculiar form of liberalism that places more confidence in local and private initiative than in the state.<sup>53</sup> The late eighteenth century idea of progress embraced the notion that municipal privilege was much the cause of that which modern enterprise and rationalism were the effect.<sup>54</sup> In an age that exalted laissez-faire in both its political and economic movements, the devolution of power to the municipal government favoring local liberty was viewed with particular favor.<sup>55</sup> Hence, one might note the close association of constitutional Home Rule and the liberal economic ethic, an association which is all too frequently contrasted, especially in regard to municipal ownership.

The thrust of Home Rule is the sustenance of local freedom,<sup>56</sup> and the operation and ownership of a municipal utility—an exercise of exclusive municipal power—exemplifies the principle of local freedom to the utmost.<sup>57</sup> The municipality acts in a proprietary function designed to further community good.<sup>58</sup> This proprietary status aligns the municipality in many respects with private corporations as the legal obligations of the two are much the same.<sup>59</sup> Authority to act is broad—coextensive with the definition of public utility—and the absence of any express constitutional limitation on municipal power is an implied bar to state encroachment through direct limitation upon municipal constitutional

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their municipalities." J. FORDHAM, MODEL CONSTITUTIONAL PROVISIONS FOR MUNICIPAL HOME RULE 1 (1953).

52. See generally G. VAUBEL, *supra* note 51, § 3, at 15.

53. W. WICKWAR, THE POLITICAL THEORY OF LOCAL GOVERNMENT 30 (1970). The author notes that the heritage of local government in the United States owes much to the experience of the Prussian and Westphalian states and to the chairs of legal philosophy in German universities. *Id.* at 31-32. Local government shared in the freedom accorded private initiative, and public responsibility was stressed in order to harmonize public and private interests. *Id.* Unimpeded by notions of *ultra vires* concerning the proper scope of public service, the municipality was free to perform any positive role that served the citizenry. For a discussion of social responsibility and the municipal utility, see text accompanying notes 65-74 *infra*.

54. W. WICKWAR, *supra* note 53, at 39.

55. *Id.* at 43.

56. See G. VAUBEL, *supra* note 51, § 27, at 385.

57. See *id.* § 100, at 1106.

58. See *id.* § 136, at 1395.

59. *Id.* at 1395-96.

power.<sup>60</sup> The municipal power does have limitations, however, when it runs in conflict with powers of the state of equal constitutional dignity. Two such limitations are areas of "statewide concern"<sup>61</sup> and areas where use of state police power is necessary to sustain public welfare.<sup>62</sup> The degree to which these limitations will affect the Home Rule protection of local governments remains unknown. However, if genuine Home Rule is to be attained, the political and judicial climate in the state must be favorable. The state must not interfere in local matters and the courts must not too quickly sway the balance away from local interest to that of the state. A broadly conceived constitutional framework does not alone suffice.

The social and ethical values of the community which are brought to bear upon the legislative and judicial branches of government condition the climate in which Home Rule must func-

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60. *Id.* at 1399-1400. See also Comment, *Public Utilities Under Home Rule*, 9 OHIO ST. L.J. 141 (1948).

61. The Ohio Supreme Court considered the doctrine of "statewide concern" in *Cleveland Elec. Illuminating Co. v. City of Painesville*, 15 Ohio St. 2d 125, 239 N.E.2d 75 (1968), where state legislation restricted the power of local government to regulate projects within its territory. Justice Mathias' majority opinion provided a balancing standard in analyzing the legislation before the court:

[E]ven if there is a matter of local concern involved, if the regulation of the subject matter affects the general public of the state as a whole more than it does the local inhabitants the matter passes from what was a matter for local government to a matter of general state interest.

*Id.* at 129, 239 N.E.2d at 78.

This standard is an extremely deferential one and creates problems for the Home Rule doctrine, largely because the standard of statewide concern is a function of time. Any issue that gains the attention of the General Assembly should be of sufficient "general state interest" to clear the low threshold of the test (as was transmission of electric power in the *Painesville* case). While the court's concern for general laws is justified, the opinion has the potential to accommodate the denial of municipal power under the auspices of Home Rule whenever there is even a slight conflict with state legislation. For a further discussion of the *Painesville* case see Vaubel, *Of Concern to Painesville—Or Only to the State: Home Rule in the Context of Utilities Regulation*, 33 OHIO ST. L.J. 257 (1972).

62. In *City of Canton v. Whitman*, 44 Ohio St. 2d 62, 337 N.E.2d 766 (1975), the Ohio Supreme Court was faced with an issue similar to that in *Painesville*—whether a local government had to accede to state infringement on its power of self-control. The City of Canton had ignored an Ohio Environmental Protection Agency order to fluoridate its public water supplies, declaring it had the right to decide what was in the best interest of the community. In this case, the Court disagreed. Justice Stern, in his majority opinion, seemingly merged the "statewide concern" issue into the question of the State's paramount police power. While recognizing home rule and general state police power as constitutionally "equivalent in dignity," *id.* at 66, 337 N.E.2d at 770, the majority clearly stated that when the co-equals conflict, state power prevails. *Id.* "An exercise of the police power necessarily occasions some interference with other rights, but the exercise is valid if it bears a real and substantial relationship to the public health, safety, moral or general welfare, and if it is not unreasonable or arbitrary." *Id.* at 68, 337 N.E.2d at 771.

tion. A favorable opinion of Home Rule has an impact far beyond the legislative or judicial outlook as it indicates the broader popular understanding of the purpose of local control that leads, in turn, to effective public articulation of its values, a step crucial to the decisionmaking process. This popular understanding is of central importance to the identification of the liberal economic values that support Home Rule and municipal ownership and operation of public utilities.

The courts assume added significance in this process since they not only must be able to reconcile competing state and municipal interests, but they must also define, in a concrete fashion, the scope of power distributed to municipalities by the Home Rule Amendments. Two recent decisions indicate that the Ohio judicial system is willing to take this crucial step and recognize the significance of Home Rule authority.<sup>63</sup> While in neither case does the court draw any rigid distinctions, it does engage in a whole-some discourse on competing values that affect its judgment in Home Rule cases.<sup>64</sup> So while the nature of constitutional Home

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63. *City of Columbus v. Ohio Power Siting Comm'n*, 58 Ohio St. 2d 435, 390 N.E.2d 1208 (1979); *City of Columbus v. Public Util. Comm'n*, 58 Ohio St. 2d 427, 390 N.E.2d 1201 (1979).

64. In *City of Columbus v. Public Util. Comm'n*, 58 Ohio St. 2d 427, 390 N.E.2d 1201 (1979), the Ohio Supreme Court was called on to decide the extent to which Home Rule curtails state power to exercise control over municipalities. Justice Holmes concluded that not every impact upon municipal power is an unconstitutional restriction.

[W]here the state enacts a statute promoting a valid and substantial interest in the public health, safety, morals, or welfare; where the statute's impact upon municipal utilities is incidental and limited; and where the statute is not an attempt to restrict municipal power to operate utilities, the statute will be upheld.

*Id.* at 432, 390 N.E.2d at 1204. He maintained, however, that the statute must fail if its purpose is to control or restrict municipal utilities. But, if a compelling interest on behalf of the state can be shown, even a substantial burden flowing to the municipality should be tolerated.

In a conclusory statement that is warmly sympathetic to Home Rule principle, Justice Holmes declared: "We have no reason to suspect that the interests of a municipality's electric heating customers will be better protected by the commission, an appointed body, than by their elected municipal representatives." *Id.* at 434, 390 N.E.2d at 1205. This statement, of striking importance as a judicial expression, recognizes in principle the manner in which individualism is accommodated by municipal Home Rule over state regulation. The case thus may be said to reflect the Court's belief that a municipality's citizen-customer constituency is as capable of achieving sound utility operation through local management as the state government in its regulation of its sector of the utility industry.

In a companion case, *City of Columbus v. Ohio Power Siting Comm'n*, 58 Ohio St. 2d 435, 390 N.E.2d 1208 (1979), the Court limited the Commission's right to interfere with the city's Home Rule power. However, the Court did uphold the power of the state to assume responsibilities should the environmental impact of the local decision extend beyond its boundaries and become a matter of statewide concern. State action in such circumstances is a valid exercise of police power by the state. The Commission was therefore left with the



Rule in Ohio presents no categorical limitation to state encroachment upon municipal self-determination of utility operations, the tenor of the court's statements is favorable to continued municipal autonomy.

#### V. THE MUNICIPAL UTILITY IN CONTEMPORARY SOCIETY—SOCIAL RESPONSIBILITY, POLITICAL RESPONSIVENESS, AND PRICING POLICY

To understand the workings of the municipal utility properly, its role in today's society must be assessed. At the present time, theorists argue three issues: (1) social responsibility; (2) political responsiveness of the owners; and (3) pricing policy. These issues pertaining to the municipal utility shall be considered in greater detail.

##### A. *Social Responsibility*

The concept of the responsibility of the individual or entity to the state or society is an ancient one. However, due to the exuberance for liberal economic thought, it did not assume great significance in American society until the Great Depression. E. Merrick Dodd began the debate with his definitive article, "For Whom Are Corporate Managers Trustees?," in the 1932 *Harvard Law Review*. He maintained that a business organization are affected not only by the laws which governed it, but also by the attitude of the public concerning the obligations which it had to society. In his now quite famous words, he stated:

That the duty of the managers is to employ the funds of the corporate institution which they manage solely for the purposes of their institution is indisputable. That that purpose, both factually and legally, is maximum stockholder profit has commonly been assumed by lawyers. That such is factually the purpose of the stockholders in creating the association may be granted. Nevertheless, the association once it becomes a going concern, takes its place in a business world with certain ethical standards which appear to be developing in the direction of increased social responsibility. If we think of it as an institution which differs in the nature of things from the individuals who compose it, we may then readily conceive of it as a person, which, like other persons engaged in business, is affected not only by the laws which regulate business but by the attitude of public and business opinion as to the social obligations of busi-

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responsibility of weighing its determination of environmental impact against the municipality's own determinations of need and evaluations of public service and convenience.

ness.<sup>65</sup>

It seems clear that this is in direct opposition to the traditional view that a corporation owes a responsibility only to its shareholders. Just one year before, Adolph A. Berle, Jr. wrote an equally significant article in the *Harvard Law Review* entitled "Corporate Powers as Powers in Trust," where he presented that view. He claimed:

It is the thesis of this essay that all powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears.<sup>66</sup>

After these two famous legal theorists, the debate over the role of social responsibility in business has continued and remains a controversial issue. One advocate of social responsibility maintains that the classical apologetic is untenable in modern society and, consequently, a new ideology is needed.<sup>67</sup> On the other hand, it has been vehemently argued that business should seek only long-run profit maximization and not adhere to political or social ideals which would lead to its ultimate destruction.<sup>68</sup> "Corporate welfare makes good sense if it makes good economic sense. . . . But if something does not make economic sense, sentiment or idealism ought not let it in the door."<sup>69</sup> Scholarship on this issue abounds.<sup>70</sup> However, the result remains that society now expects more and more corporate responsibility and is beginning to obtain it through never-ending government regulation. In spite of the strong arguments against corporate responsibility, in response to the acceptance of shifting social values in the commu-

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65. Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1045, 1159 (1932).

66. See Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931).

67. Mason, *The Apologetics of Managerialism*, THE JOURNAL OF BUSINESS, 1-11 (Jan. 1958). See also Austin, *Responsibility for Social Change*, HARV. BUS. REV. 45-52 (July-Aug. 1965); Frederick, *The Growing Concern Over Business Responsibility*, CAL. MANAGEMENT REV. 54-61 (Summer 1960).

68. Levitt, *Dangers of Social Responsibility*, HARV. BUS. REV. 41-50 (Sept.-Oct. 1958). See also Donham, *Is Management A Profession*, HARV. BUS. REV. 60-68 (Sept.-Oct. 1962); Peters, *The Essential Values of Business*, MANAGEMENT AND SOCIETY 52-59 (1968).

69. Levitt, *supra* note 68, at 48.

70. H. JOHNSON, BUSINESS IN CONTEMPORARY SOCIETY: FRAMEWORK AND ISSUES (1972); S. SETHI, THE UNSTABLE GROUND: CORPORATE SOCIAL POLICY IN A DYNAMIC SOCIETY (1974); G. STEINER, ISSUES IN BUSINESS AND SOCIETY (1972). See generally Morton, *A Critical View of Management's Assumption of Social Responsibilities*, NEW CHALLENGES TO PUBLIC UTILITY MANAGEMENT 213 (1974).

nity, corporations are beginning to assume these "responsibilities" voluntarily. This trend also reflects the various changes in corporate structure and methods of operation.<sup>71</sup>

Although both the large public utilities and the community-oriented municipal utilities are subject to outside government regulation, the pressures the community exerts on each do vary. Most people will not make many demands on the large interstate public utility. Some pressure from the community does exist, but any small community is but one segment of the utility's vast domain and any response will undoubtedly be impersonal. In contrast, since the municipal utility is relatively small and exists only to serve the needs of the community in which it is located, it will be most responsive to the pressures of that community.

An example of these pressures and the various responses of the two utilities might be seen in the environmental costs of conducting a utility enterprise.<sup>72</sup> Many of the huge companies have their enormous power plants near a particular community because a water or coal service is there. Conservation efforts may help this community, but they certainly do not help the profits of the public utility. Thus, the utility will usually do as little as possible to restore the natural environment. On the other hand, the municipality will be willing to minimize the damage by its utility to its own local environment. Its utility must bear costs of environmental laundering of polluting facilities such as electric generating and waste treatment plants.<sup>73</sup> The municipality operating its own local utility surely will obtain responsible environmental and conservation advice and act on it, since whatever is done will further the interests of the community itself. However, should a municipality abdicate this responsibility, state and federal authorities will pursue more active measures to maintain environmental standards, resulting in an erosion of Home Rule autonomy.

### B. *Political Responsiveness*

Large public utilities are stock corporations and, except for

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71. T. PETIT, *THE MORAL CRISIS IN MANAGEMENT* 134 (1967). The author cites the use of corporate largesse, expanding corporate bureaucracy, separation of ownership and control, professionalization of management, and the diffusion of corporate property rights as examples of such changes.

72. Air, water, and landscape pollution with attendant health hazards and aesthetic distortions constitute prevalent technological diseconomies.

73. Environmental laundering is an example of reducing social costs otherwise suffered due to smoke, smell, thermal, water, and noise pollution; encroachment on water levels; and over-consumption of nonrenewable natural resources.

federal and state regulation, are primarily controlled and operated by a managerial elite. As Berle and Means write in their classic work, *The Modern Corporation and Private Property*:

[P]arallel with the growth in the size of the industrial unit has come a division in its ownership such that an important part of the wealth of individuals consists of interests in great enterprises of which no one individual owns a major part. . . .<sup>74</sup> Frequently . . . ownership is so widely scattered that working control can be maintained with but a minority interest. Under such conditions control may be held by the directors or titular managers who can employ the proxy machinery to become a self-perpetuating body, even though as a group they own but a small fraction of the stock outstanding.<sup>75</sup>

Furthermore, concerning the actual power and responsibility of these large corporate systems, Berle and Means state:

A large body of security holders has been created who exercise virtually no control over the wealth which they . . . have contributed to the enterprise. . . .<sup>76</sup> Henceforth, in the corporate system the 'owner' of industrial wealth is left with a mere symbol of ownership, while the power, the responsibility and the substance . . . are . . . transferred to a separate group in whose hands lies control.<sup>77</sup>

In contrast to the managerial elite who control public utilities, the municipal utility management is directly linked to city management, the latter serving as an effective barometer of performance. The city's governing body, acting in a political capacity, expresses the value preferences to which the utility management must aspire. It becomes the pulse of public approval. To a degree, then, the public gets the utility service it is willing to demand, though it assumes the risk of mediocre performance should it fail to insist upon responsible management of its utility enterprise. This risk, however, is one which the public must be willing to accept in opting for the local freedom that Home Rule allows. On the other hand, this freedom does allow the municipality to be innovative in furthering its self-interest, the sort of innovation that might otherwise be unavailable on a broader, state scale. Ideally, method of operation and service pricing can be designed to complement civic goals. This is the value of local self-determination.

The concept of social responsibility, however, does present a

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74. A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 66 (1933).

75. *Id.* at 4-5.

76. *Id.*

77. *Id.* at 68.

problem concerning the proper structure of power in economic life. Although power is vital to the accomplishment of civic goals, the public may fear the existence of concentrated economic power and the abuses which might ultimately result therefrom. This fear exists because public ownership is inevitably associated—and all too often confused—with political ownership.<sup>78</sup> Consequently, there is no doubt that the success of public ownership will extend only as far as it can be divorced from political patronage.

### C. *Pricing Policy*

Of the three issues discussed here, pricing policy is perhaps the most important because of the dangerous potential for political abuse that is inherent within it. Governments, acting for political purposes, might alter the method of pricing away from the full cost method and thereby threaten the utility's ability to remain self-sustaining. To illustrate, in the 1930's Professor Harold Hotelling advocated a different pricing method for utility services: short-term marginal cost. He maintained that fully allocated costs were unstable and led to cyclical fluctuations and uneconomical use of labor and other resources.<sup>79</sup> When shortages occurred, Hotelling advocated the use of tax subsidies.<sup>80</sup> His philosophy was that the general welfare is promoted by "generous support of projects for communal spending . . . without attempting to recover from each enterprise its cost by charges for services rendered by that enterprise."<sup>81</sup> To make services of the enterprise fully available and thereby maximize the utilitarian objective, Hotelling thought it necessary to eliminate consideration of such costs in pricing policy. He also suggested that all prices should be proportional to marginal costs, which could theoretically be accomplished if every commodity and service were subjected to a tax proportional to its marginal costs.<sup>82</sup>

The danger of this approach is that by disregarding the utility's self-sufficiency, it invites political over-involvement in utility operation. If goals of sound utility practice are substituted for political favors, the utility's institutional foundation will be severely

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78. See E. CLEMENS, *supra* note 49, at 560.

79. Hotelling, *The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates*, 6 *ECONOMETRICA* 242 (1937). Hotelling relied on Jules Dupuit's thesis that "the optimum of the general welfare corresponds to the sale of everything of marginal cost." *Id.* at 242.

80. *Id.* at 257.

81. *Id.* at 260.

82. See generally Hotelling *supra* note 12.

undermined. The liberal values upon which any local utility operation depends for its freedom from state intervention would succumb to the socialization of the utility and to its concurrent disregard of acceptable economic practice.

In addition to these theoretical objections pragmatic difficulties exist with short-term marginal cost pricing. As Bonbright notes, the great elasticity of short-term costs makes the short-term marginal cost method of pricing extremely volatile.<sup>83</sup> This instability does not serve consumer expectations that present rates indicate that pricing will remain in effect for a considerable period.<sup>84</sup> On the other hand, it is the anticipated long-run cost of service which is taken into account when a consumer faces any business decision.<sup>85</sup>

A glittering example of the dangers of disregarding a utility's self-sufficiency (thereby leading to political involvement) and of the problems that arise when utility companies do not adhere to long-run marginal costs can be seen in the following actual situation.

The Southern Company, one of the largest utilities in the United States, serving Georgia and portions of Alabama, Mississippi, and Florida, is unable to raise rates due to political restrictions. Because it lacks sufficient capital to operate, the company is cutting back on necessary construction projects, possibly jeopardizing its future. Because it has fallen prey to the whims of politically controlled public service commissions, the company has also been forced to reduce its peak hour reserve in future capacity from the industry norm of 20 percent to a risky 15 percent. Should one or more generating units break down, this reserve may prove insufficient.

In a discussion of Southern's quandry, Edmund Faltermayer relates:

These days Southern is in a permanent state of suspense about what it will get in the way of rate relief. Of the four state commissions the Southern system deals with, only Florida's has become reasonably accommodating in the last few years. Mississippi is at the opposite pole; the rate increases it al-

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83. J. BONBRIGHT, *supra* note 24, at 323.

84. *Id.* at 396.

85. In his discussion of marginal cost pricing, Bonbright expressed a preference for long-run marginal cost pricing as the most important marginal costs for rate control are the persistent marginal costs. He felt that such a pricing policy was superior not only from the standpoint of optimum resource allocation, but also because it presented a less drastic departure from the orthodox requirement of full cost pricing. *Id.* at 401.

lows—when it allows them at all—are so meager its rulings are always appealed to the state courts. The Georgia and Alabama commissions, which rule over the great bulk of the Southern system's earnings, are somewhere in between but closer to Mississippi. Despite Georgia Power's brush with bankruptcy, that state's commission in 1975 granted only one-third of a requested permanent rate increase; last year, as noted, it granted only half the utility's request and cut the allowed rate of return. The real shocker, though, was the Alabama commission's June, 1976, decision on a request for a \$106.8 million rate increase. . . . [T]he commissioners chose, by a vote of two to one, to give Alabama Power not one red cent.<sup>86</sup>

This utility is gradually losing its identity as an independent, regulated utility and has become a "political football," the result of which can only be the bankruptcy of the company and the ultimate takeover by the states involved. The liberal economic tool—price—is being ignored to the detriment of all.

To avoid this depressing fate, a municipal utility should utilize the pricing policies that reflect the liberal economic and political basis upon which this form of local public ownership of business was founded. Preservation of economic independence is essential to shelter the municipal utility from state encroachment and political abuse. To this end, a municipal business should be operated in much the same manner as any privately owned business.

## VI. OVERALL ANALYSIS

In Samuel Taylor Coleridge's "The Rime of the Ancient Mariner,"<sup>87</sup> an innocent, loving albatross is unjustifiably killed, and as a result, the mariners suffer a terrible penalty. The municipal utility, like the albatross, exists in danger of being ushered into extinction.<sup>88</sup> Unlike the Coleridge theme, however, were the termination of the municipal utility to occur, nothing so drastic as the mariner's fate would befall American democracy. On the contrary, if municipal utilities were to be extensively curtailed or eradicated, the overall democratic setting would change little, for they are, in fact, such a small part of the economic, legal, and political setting. The point is, however, that the liberal economic

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86. Faltermayer, *THE HAMMERLOCK ON SOUTHERN CO.*, *FORTUNE* May 8, 1978, at 277.

87. S. Coleridge, "The Rime of the Ancient Mariner," in *IMMORTAL POEMS OF THE ENGLISH LANGUAGE* 269 (O. Williams ed. 1952).

88. There are those who differ, but as long as the corporate theme is growth—because it is supposedly more efficient—then, the relatively small municipal utility is in danger of being absorbed by the huge private utilities.

goal of freedom remains important even with a supplemental policy of guided governmental intervention in the model. And, the municipal utility is only one part of this economic, legal, political whole. Yet, every part adds to the whole, and given the tremendous inroads into the model that have been made, it seems that that which retains the original goals with little or no crippling side effects, no matter how small its effect, should be preserved.

Granted there is an anomaly—the municipal utility is a natural monopoly that is municipally owned. But this anomaly is offset by the insistence upon a pillar of the liberal economic ideal—profit. Profit, as a component remains central since it disallows government welfare expenditures. Those who benefit from the municipal utility must pay for present and future costs.

Furthermore, this anomaly is offset by size, since the size of the municipality is generally small, especially in comparison with huge public utilities. The entire theme of freedom was invented and initially developed in small city states. Rousseau in *The Social Contract*<sup>89</sup> and Schumacher in *Small is Beautiful*<sup>90</sup> maintain that small equals more democracy. And others have added that representation of different geographic areas also increases and guarantees democracy.<sup>91</sup> Moreover, the constitutional sanction of the municipal utilities and the lack of state and federal control add to the ideal of small individual decisionmaking for the benefit of the community.

Pitfalls such as politicalization, corruption, and bureaucratization exist not only in government owned organization, but also in huge public utilities of today. Yet these menacing pitfalls have been held at a distinct minimum in small municipal utilities. Consequently, in today's modern, pluralistic society, we must not assume we can go back to the pure liberal economic model. We must go on, though, with the pluralistic society which is expressed by many different groups whose needs may be satisfied in many different ways. These functional entities will nonetheless contribute to the spirit and actualities of the democratic whole.

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89. J. Rousseau, *The Social Contract* in *ESSENTIAL ROUSSEAU* 57 (L. Bair trans. 1974).

90. E. SCHUMACHER, *SMALL IS BEAUTIFUL: ECONOMICS AS IF PEOPLE MATTERED* 70 (1973). Schumacher says: "[P]eople can be themselves only in small comprehensive groups. Therefore we must learn to think in terms of an articulated structure that can cope with a multiplicity of small-scale units. If economic thinking can not grasp this it is useless." *Id.*

91. *THE FEDERALIST* No. 10 (J. Madison).



## VII. CONCLUSION

Marked by his concern for finding the right way to reconcile conflicting demands of stability and change in the law, Benjamin Nathan Cardozo gained an international reputation for his skill in harmonizing legal rules and social values. In *The Paradoxes of Legal Science*, Justice Cardozo affirms the Lockean statement that "the end of law is not to abolish or restrain, but to preserve and enlarge freedom."<sup>92</sup> And just as freedom needs preserving, so too do certain business practices, operating within the liberal economic mode, require preservation and safekeeping by the law. Herein, the municipal utility occupies a special and successful niche in business enterprise.

Municipal ownership, when limited to natural monopolies, has a most definite liberal economic character. As a result of its small size, purely local interest, and profit orientation, this form of public control maintains prominent liberal economic values—individualism and self-determination, and by limiting direct state control, it responds to the preoccupation of laissez-faire with curtailing government largesse.

The dignity of constitutional sanction, contemporary recognition of Home Rule's grass roots democratic faith, and the insistence upon profit provide a sound basis for preserving and encouraging freedom and independence of municipal utility operation.

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92. B. CARDOZO, *THE PARADOXES OF LEGAL SCIENCE* 94 (1928).